

CHAPTER 4

STATE COMMUNITY DEVELOPMENT BLOCK GRANT (CDBG) PROGRAM

- 4-1 APPLICABILITY. Chapter 4 is applicable to the review of the State Community Development Block Grant (CDBG) Program only. Review of activities under the HUD Small Cities/Hawaii nonentitlement and Insular Areas CDBG Programs follow the guidance found in Chapter 3. Only Subpart I of the regulations at 24 CFR Part 570 is directly applicable to the State CDBG program with the following exceptions: 24 CFR 570.606, acquisition and relocation, applies to the State program per 24 CFR 570.488; 24 CFR 570.200(j), faith based organizations, applies per 24 CFR 570.480(e); 24 CFR 570.513, lump sum draw downs, applies as it is the only regulation promulgated by the Secretary; and 24 CFR 570.707(b) applies the requirements of Subpart M to State-assisted public entities for the Section 108 Loan Guarantee Program. According to 24 CFR 570.480(c), HUD will give maximum feasible deference to a state's interpretation of the statutory requirements and the regulatory requirements of Subpart I, provided that these interpretations are not plainly inconsistent with the Housing and Community Development Act of 1974 ("the Act").

States may also choose to adopt more restrictive requirements and/or portions of the regulations for the CDBG Entitlement program (also at 24 CFR Part 570). While Entitlement requirements found outside of Subpart I can be presented to a state as "interpretive guidance," failure to comply with such requirements cannot be used to support a Finding of Noncompliance under the State CDBG program unless a state has previously adopted that portion of the Entitlement rule.

A state has much flexibility in establishing its own procedures for administering State CDBG funds and providing oversight of its state recipients. A Finding of Noncompliance may also be determined based on evidence of failure to comply with a state's own requirements.

- 4-2 REVIEW OBJECTIVES. The principal objectives of the State CDBG Program review are:
- A. To ensure that a state's program is being administered in accordance with applicable statutory and regulatory requirements;
 - B. To provide an early indication of problems or potential problems in meeting applicable program requirements and to avoid fraud, waste, and mismanagement; and
 - C. To promote efficient and effective program participant performance.

4-3 BASIS FOR THE REVIEW. Under the State CDBG program, states are considered to be the program participant. By statute, states must directly distribute program funds to units of general local government, sometimes referred to as state recipients. As required by section 104(e) of the Act, and outlined in Subpart I of the CDBG regulations at 24 CFR 570.493, HUD must annually determine whether a state has:

- A. Distributed funds to these units of general local government in a timely manner and in conformance with the method of distribution in accordance with its Annual Action Plan,
- B. Carried out its certifications in compliance with Title I and other applicable laws and Subpart I of the CDBG regulations, and
- C. Made reviews and audits of units of general local government (state recipients) as may be necessary or appropriate to determine whether they have satisfied the applicable performance criteria described in section 104(e) of the Act. Primary and direct responsibility for overall administration of CDBG funds distributed under Subpart I of the regulations is vested in a state. Subject to the primary objective and other requirements of the Act, a state is free to develop purposes and procedures for distributing funds.

4-4 FOCUS OF THE REVIEW. States are dealing with sophisticated issues, growing inventories of recipients, and complex problems. As mentioned, a state has some flexibility in interpreting the statute and regulations, and in establishing its procedures for administering CDBG funds. For these reasons, it makes more sense for HUD reviewers to evaluate how a state is managing to meet its statutory responsibilities from a broad perspective, as well as reviewing specific state level files on individual cases to ensure that a state's systems are being consistently implemented. Thus, the monitoring Exhibits in this Chapter include both questions about the management systems that a state uses to meet program requirements and worksheets to help document the examination of individual files.

- A. States' Flexibility. States typically develop systems in the following areas to carry out statutory requirements: Eligibility and National Objectives; Review of Recipients; Financial Management (including Audit Management); and Grant Closeout. For Eligibility and National Objectives, Review of Recipients, and Grant Closeout, states are not required to have specific systems. Exhibits 4-1, 4-2, 4-6, and 4-8 contain questions related to both program requirements as well as suggested good management practices. States may develop new or use existing systems, whichever method is most appropriate for their needs and reflects their own particular circumstances.

- B. Required Elements. States are, however, required to comply with certain elements of OMB Circular A-133, “Audits of States, Local Governments, and Non-Profit Organizations,” and OMB Circular A-87, “Cost Principles for State, Local and Indian Tribal Governments.” Monitoring questions covering these required areas are included in Exhibit 4-7, “Guide for Review of Financial Management.”

4-5 STRUCTURE OF THE EXHIBITS. Exhibits 4-1, 4-2, 4-6, 4-7, and 4-8 contain questionnaire sections as well as worksheets. The questions are designed to help the reviewer determine basic components of state-designed systems. The questionnaire section in these Exhibits may be completed based on any or all of the following resources: interview with state or local government staff, review of written state policies, procedures and related correspondence, and/or review of sampled activities or other documentation. The worksheets are specifically structured to document the results of examining a sample of activities in order to test a state’s implementation of the system described. In most cases, the reviewer should both answer the questions and complete the worksheets.

- A. Partial Completion of Exhibits. In limited instances, the HUD reviewer, with concurrence by the CPD Field Office director, may determine that a topic review will be satisfied by completing only the questionnaire portion of the exhibit (in which case this would be notated on the Exhibit itself). Examples of when this might be appropriate include instances where:

1. The HUD reviewer is new to a state’s CDBG program, or a state has not been monitored in a significantly long period of time, and the primary focus of the monitoring visit is to gather basic information on a wide variety of areas both to validate risk and select areas for future reviews. In such cases, the next monitoring visit should be scheduled no later than the following federal fiscal year, and sooner if significant risk is identified.
2. The review timetable does not allow for sampling in an area, perhaps due to issues encountered while reviewing other areas, but the Field Office decides that the minimal system review is necessary in order to determine whether sufficient risks exist in the additional area(s) to justify extending the monitoring visit or scheduling an additional monitoring visit.

4-6 FILE SELECTION AND SAMPLING. As described in Chapter 2, the risk analysis process will be used to determine which states and areas should be reviewed. Once that process has been completed, the HUD reviewer should consider the following factors when determining which specific files within an area should comprise the review sample for the selected state:

- A. In general, initial file selection should be made using a random selection method.
 - B. The reviewer would consider adding more files to this selection or using a non-random selection in order to:
 - 1. Examine files from each category of activity being reviewed (e.g., economic development, public facilities);
 - 2. Include a file(s) from each state staff person responsible for oversight of state recipients;
 - 3. Expand the sample if possible to include additional files with the same characteristics, if indicated by the severity or nature of any problems(s) noted during the initial selection's review (for example, same problem category, same state staff person, same activities or other characteristics). This expanded sampling aids in determining whether problems were isolated events or represent a systemic problem;
 - 4. Expand the sample to include new types of activities, activities considered high risk, and unresolved past problems.
- 4-7 RECIPIENT REVIEWS. As stated above, states are considered to be HUD's program participants in the State CDBG program. Units of general local government funded by a state are considered to be their recipients. Every state program monitoring does not require recipient-level review. Recipient-level reviews should be performed periodically, as indicated by the risk analysis and other pertinent factors considered by the Field Office.

If recipient reviews are conducted, state officials must be given the opportunity to participate in the review with HUD staff. If the review is on-site, to the extent possible, it should not always be restricted to recipients located in convenient or near-by locations.

The primary focus of a recipient review is to test a state's oversight and documentation systems by verifying state system information against information available in the recipient's records. However, HUD staff may make findings at the recipient level if noncompliance is noted. In this event, state staff will oversee the resolution of recipient issues raised and report progress and resolution to HUD. Field Offices should notify Headquarters if extenuating circumstances indicate that HUD should directly oversee the resolution of recipient noncompliance.

- 4-8 RECORDKEEPING. States are required to establish and maintain necessary records sufficient to facilitate HUD reviewers in determining whether a state has fulfilled its responsibilities as described in Section 4-3 above. 24 CFR 570.490 also states that the specific record keeping requirements of the program “shall be as jointly agreed upon by HUD and the states.” When this regulation became effective (December 1992), HUD and states agreed upon the Model Record Keeping Requirements. The Model Record Keeping requirements are contained in Appendix I of the July 2002 publication, “*State CDBG Guide to National Objectives and Eligible Activities.*”

To the extent that the State CDBG regulations are revised, the record keeping requirements would be updated, as appropriate. Any such revised record keeping requirements would supersede the above-referenced Model Record Keeping Requirements. Because a separate Exhibit for monitoring record keeping has not been developed due to anticipated changes, HUD reviewers are to use as guidance the requirements contained in Appendix I of the “*State CDBG Guide to National Objectives and Eligible Activities.*” Note, however, that these requirements do not fully address all aspects of the regulations that affect record keeping. Three significant differences exist between the current regulations and guidance:

- A. The Financial Management section of the record keeping requirements contains out-of-date references to OMB and Treasury Circulars that have since been replaced. The language in that section should not be relied on as reflecting current requirements.
- B. Where regulatory citations have been superceded, the version contained in Appendix I of the State CDBG Guide contains editorial notes that indicate the current regulatory citation for the requirement.
- C. The Model Record Keeping Requirements do not address compliance with *public benefit standards*. Regulations regarding public benefit standards requirements were issued in the January 5, 1995, CDBG Economic Development rule. 24 CFR 570.482(f)(6) and (g) spell out documentation requirements for demonstrating compliance with the public benefits standards. Monitoring guidance for this topic is also contained in Exhibit 4-2. Other areas in which the Model Record Keeping Requirements are out of date include: program income requirements; Community Revitalization Strategy Areas; compliance with the statutory job-pirating prohibition; Integrated Disbursement and Information System (IDIS); and the Consolidated Plan.

HUD reviewers should assess whether state records support HUD’s determinations as outlined under section 4-3 of the Chapter, as well determine compliance for the areas described in section 4-9, A through H. As stated in 24 CFR 570.493(b), a state’s failure to maintain records *may* result in a finding that a state has failed to meet the applicable requirement to which the record pertains.

At the reviewer's discretion, a finding related to a lack of documentation may be based on this citation alone or in conjunction with the citation from another technical compliance area.

- 4-9 **REVIEW AREAS.** While Exhibits 4-1 through 4-8 contain specific instructions pertaining to their use, this section provides some additional guidance.
- A. **ELIGIBILITY AND NATIONAL OBJECTIVES.** Evaluating compliance with these requirements is a two-step process. First, at the time of approval, a state must determine that each activity it proposes to fund is eligible and meets a national objective. Second, following implementation of activities, a state must determine whether the activities carried out did meet the national objective and represented the same eligible activities as those originally approved. In most cases, the reviewer should both answer the questions and complete the worksheet in Exhibit 4-1. The worksheet is structured to document the results from examining a sample of activities to test a state's implementation of their systems.
 - B. **ECONOMIC DEVELOPMENT.** When economic development activities are being reviewed, the reviewer should first review for compliance with basic eligibility and national objective requirements using Exhibit 4-1 and then *also* complete Exhibit 4-2. Exhibit 4-2 is designed to *supplement* Exhibit 4-1 by focusing solely on the additional requirements that economic development activities are subject to, primarily underwriting standards and public benefit tests.
 - C. **OVERALL BENEFIT.** As required by 24 CFR 570.484, states must ensure that not less than 70 percent of the CDBG funds it receives are used for activities benefiting low and moderate income persons over a period of a state's choosing. This period cannot exceed three years (allocations). Exhibit 4-3 has been designed to assist the HUD reviewer in this area. Evaluating compliance with this requirement occurs at two stages of a state's funding cycle:
 - 1. Following approval of grants to recipients, the reviewer will examine records to determine progress against the 70 percent requirement for the period a state has chosen.
 - 2. At the time of closeout of the last allocation for the period a state has chosen, the reviewer will again examine records to determine if the 70 percent overall benefit requirement was actually met.
 - D. **METHOD OF DISTRIBUTION.** HUD is required to determine whether or not a state distributed its funds in conformance with the method described in its Consolidated Plan and Annual Action Plans. (Consolidated Plan requirements for states are outlined in Subpart D of 24 CFR 91.) The reviewer should use Exhibit 4-4 when making determinations of state performance in this area.

1. Method of Distribution conformance reviews should focus on the most recently completed allocation year. While the current allocation year can be reviewed as well, the reviewer can only reach a final determination when all of the funds from an allocation have been obligated. Reviews that occur before this point should result in progress determinations.
2. The reviewer should verify that applications for funding were selected according to the method of distribution described by a state in its corresponding Annual Action Plan. If the Annual Action Plan contains threshold requirements which impact selection and grant ceilings, these should be included in the review.
3. If program income, reallocated funds, and/or recaptured funds are being distributed, the Annual Action Plan must be reviewed to determine if it contains provisions for these types of funds, and if the provisions are being followed.
4. Per the requirements at 24 CFR 91.505, any change from the method of distribution described in the Consolidated Plan/Annual Action Plan requires an amendment. A state is responsible for identifying in its Citizen Participation Plan the criteria it will use for determining what constitutes a substantial amendment. Substantial amendments are subject to a citizen participation process, as outlined under a state's Citizen Participation Plan. (Additional information about state Citizen Participation Plan requirements is located at §91.115.)
5. Review of a state's conformance with its method of distribution should consider whether a state's Annual Action Plan has been amended, if appropriate. In the event that a Plan was amended, the reviewer should determine whether citizen participation requirements were met based on a state's definition of a substantial amendment.

E. **TIMELY DISTRIBUTION.** Exhibit 4-5 has been designed to assess conformance with the dual requirement that a state distribute funds to its unit of local government recipients in a timely manner by:

1. obligating and announcing a state's annual grant commitments (except for state administrative and technical assistance funds) within 15 months of the date the grant agreement was signed by the state; and

2. expeditiously obligating and announcing the commitment of any funds that have been recaptured or program income that has been received by a state.

States are encouraged, but not required, by 24 CFR 570.494(a) to obligate and announce 95% of their annual award within 12 months of signing the grant agreement with HUD.

F. STATE REVIEW OF GRANT RECIPIENTS. HUD is required to determine whether or not a state has made reviews and audits of its unit of general local government recipients. In meeting its review responsibilities in the three areas listed in paragraph 1 below, a state is not required to undertake an on-site review of each recipient every year. However, HUD expects states, at a minimum, to review each grant on-site before closeout. While there may be exceptions (such as planning only grants which do not need to be reviewed on-site) or other mitigating circumstances, in almost all cases an on-site review is necessary for a state to ensure reasonable oversight of compliance requirements, particularly eligibility and national objectives.

1. Exhibit Structure. Exhibit 4-6 has been designed to assist the HUD reviewer in assessing compliance with three specific statutory recipient requirements:
 - i. Has a state determined that its recipients have carried out their activities in a timely manner?
 - ii. Is a state conducting reviews to determine if its recipients are carrying out their activities in compliance with Title I and other applicable laws, the State CDBG Program regulations, and applicable Executive Orders?
 - iii. Has a state determined whether or not its recipients have a continuing capacity to carry out their activities in a timely manner?

In most cases, the reviewer should both answer the questions and complete the worksheet in Exhibit 4-6. The worksheet is structured to document the results from examining a sample of activities to test a state's implementation of their systems. Reviewers should examine the combined scope of coverage under all of the methods that a state uses to review its recipients, both on-site and remotely, to ensure that the state review process is sufficient to determine whether recipients are in compliance with Title I, the State CDBG Program regulations, Executive Orders, Civil Rights, Labor Standards, Environment, Relocation, Replacement Housing, and Real Property Acquisition requirements.

2. Time Analysis. If implementation of a state's system or process for a period of years is tested using the Exhibit 4-6 Worksheet, reviewers should include samples by program year and type of activity. In order to make a determination about whether or not a state is conducting an adequate number of reviews across the spectrum of active grants and applicable requirements, the reviewer should compare actual review accomplishments against a state's own standards and review selection criteria, as well as HUD's expectations as discussed under in the introductory paragraph of this section (F) above.
 3. Close-out Review. When all grants for a period have been completed and a state is preparing to close out the allocation, the reviewer should examine all monitoring for that year's activities and reach a conclusion about whether or not the state's review was adequate in comparison with HUD's expectation that states should monitor each grant on-site before closeout, as discussed in the introductory paragraph of this section (F) above.
- G. ADMINISTRATIVE REQUIREMENTS. Exhibit 4-7 has been designed to assist the HUD reviewer in determining that a state has established sufficient administrative policies and procedures in the areas of Financial Management; Program Income; Cash Management; Cost Allowability and Allocability; Procurement; Property Management; Record Retention and Custody; Bonding and Insurance; Conflict of Interest; and Audits Management Systems.
1. State Flexibility. A state has considerable latitude in establishing its own administrative procedures and requirements in a number of these areas. Note that 24 CFR Part 85 and most of the CDBG regulations at Part 570, other than Subpart I, *do not* apply to states *unless they choose* to adopt all or parts of these requirements. Exhibit 4-7 and the detailed instructions therein have been designed to assist the reviewer in understanding this concept of state flexibility vis-à-vis state requirements for demonstrating compliance.
 2. Additional Guidance for Monitoring Administrative Requirements. Reviewers who need additional guidance on monitoring these administrative topics may want to refer to the CDBG Entitlement Program Exhibits 3-18 through 3-21 in Chapter 3 for assistance in identifying issues that may be relevant to making overall assessments on a topic. However, findings of noncompliance can

only be made based upon: the Act; 24 CFR Part 570, Subpart I; and/or a state's own procedures (including portions of 24 CFR part 85 or CDBG Entitlement regulations that have been officially adopted by a state.)

- H. GRANT CLOSEOUT SYSTEM. Exhibit 4-8 has been designed to assist the reviewer in assessing compliance with the requirement for states to establish and implement systematic requirements for timely closeout of grants to units of general local government. In most cases, the reviewer should both answer the questions and complete the worksheet. The worksheet is structured to document the results from examining a sample of activities to test a state's implementation of their systems.